IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77- 952

GROUP LIFE AND HEALTH INSURANCE COMPANY, also known as BLUE SHIELD OF TEXAS, *et al., Petitioners,*

v.

ROYAL DRUG COMPANY, INC., doing business as ROYAL PHARMACY OF CASTLE HILLS and DISCO PRESCRIPTION PHARMACY, *et al., Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Group Life and Health Insurance Company, Rieger/Medi-Save Pharmacies, Inc., Walgreen Texas Co. and The Sommers Drug Stores Company petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the United States District Court for the Western District of Texas is annexed hereto as Appendix A ("App. A") and is reported at 415 F.

Supp. 343. The opinion of the United States Court of Appeals for the Fifth Circuit is annexed hereto as Appendix B ("App. B") and is reported at 556 F.2d 1375.

JURISDICTION

The judgment of the Court of Appeals was entered on August 8, 1977, and is annexed hereto as Appendix C. A timely Petition For Rehearing And Rehearing En Banc was denied on October 27, 1977. *See* Appendix D. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

The McCarran-Ferguson Act ("McCarran Act") expressly renders the Sherman Act inapplicable to the "business of insurance" to the extent such business is regulated by state law, except in cases of "boycott, coercion, or intimidation". The question presented for review is whether the "business of insurance" includes direct contractual arrangements between an insurer and third parties to provide benefits owed to the insurer's policyholders when such contractual arrangements are required by the policy of insurance.

STATUTES INVOLVED

The provisions of the McCarran Act involved in this case, §§ 1, 2, 3(b), 59 Stat. 33 (1945), 15 U.S.C. §§ 1011, 1012, 1013(b) (1970), are set forth in Appendix E.

STATEMENT OF THE CASE[1]

Petitioner Group Life and Health Insurance Company, also known as Blue Shield of Texas ("Blue Shield"), is an insurance company duly authorized by the Texas State Board of Insurance to transact the business of life, health and accident insurance within the State of Texas. Petitioners Walgreen Texas Co., The Sommers Drug Stores Company and Rieger/Medi-Save Pharmacies, Inc., own and operate pharmacies in San Antonio, Texas. Respondents, plaintiffs below, are eighteen pharmacy owners and operators also doing business in San Antonio, Texas.

Respondents' antitrust action for treble damages and injunctive relief challenges Blue Shield's prepaid prescription drug insurance policies and contractual agreements under which pharmacies provide drugs to Blue Shield's policyholders and are reimbursed by Blue Shield. The purpose of the contractual agreements is to provide benefits to the insureds under the policies, and the policies obligate Blue Shield to contract with pharmacies to provide such benefits. Blue Shield's insureds are entitled to receive prescription drugs from any pharmacy. If the pharmacy selected by the insured has entered into a written contract ("Pharmacy Agreement") with Blue Shield, the insured is required to pay no more than a $2.00 deductible for each prescription. Such pharmacies are designated as "Participating Pharmacies".

Under the Pharmacy Agreement, a Participating Pharmacy agrees to dispense drugs to Blue Shield's

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[1] The operative facts are essentially uncontested and are fully and fairly set forth in the District Court opinion.

insureds, to accept $2.00 as full payment from the insured for each dispensed drug, and to bill Blue Shield for the cost of the dispensed drug. Blue Shield agrees to reimburse the Participating Pharmacy for its acquisition cost of each dispensed drug. If the insured's prescription is filled by a pharmacy other than a Participating Pharmacy, the policy provides that Blue Shield will reimburse the insured for 75% of the usual and customary charge for the drug, less the $2.00 deductible. The three pharmacy petitioners and nine of the eighteen respondents are Participating Pharmacies in the San Antonio area. The opportunity to enter into a Pharmacy Agreement has been and is available to all licensed pharmacies in the State of Texas, including each of the respondents.

This program is regulated by the State of Texas and permission for its use has been obtained from the appropriate authorities. The Texas Insurance Code requires that all new policy forms proposed to be issued by life, health, and accident insurers must be filed with the State Board of Insurance and approved, or exempted from approval, prior to issuance or use. Tex. Ins. Code Ann. art. 3.42 (1963). Blue Shield's prescription drug policy forms and the annexed Pharmacy Agreement were duly filed with the State Board prior to issuance or use, and the Commissioner of Insurance ultimately authorized their issuance and use in the State of Texas. Accordingly, Blue Shield was and is subject to all regulatory requirements of the Texas Insurance Code, including regulation of policy provisions and coverages and prohibitions on unfair competition or practices in the business of insurance. In order to implement the benefits provisions of the

policies, Blue Shield has entered into the Pharmacy Agreement with pharmacies throughout the State.

Respondents candidly admit in their complaint that in selling prepaid prescription drug insurance, Blue Shield is engaged in the "business of insurance." They contend, however, that in contracting with pharmacies to provide the policy benefits to its insureds, Blue Shield is somehow not engaged in the "business of insurance" within the meaning of the McCarran Act.

Respondents allege that the Pharmacy Agreement thus constitutes an actionable combination and conspiracy to fix retail drug prices and an agreement to cause Blue Shield's insureds to refuse to deal with certain of the respondents, in alleged violation of § 1 of the Sherman Act, 15 U.S.C. § 1 (Supp. 1977). The District Court granted petitioners' motions to dismiss for failure to state a claim on the grounds that both the policies and the Pharmacy Agreement were immunized from the Sherman Act by the McCarran Act. Relying upon this Court's decision in *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969),[2] the District Court determined that the policies and the Pharmacy Agreement were part of the "business of insurance",

[2] In *National Securities*, this Court established the following standards for determining when the conduct of an insurance company comes within the "business of insurance":

> Certainly the fixing of rates is part of this business. . . . The selling and advertising of policies . . . and the licensing of companies and their agents . . . are also within the scope of the statute. . . . The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the 'business of insurance.' Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. 393 U.S. at 460. (Citations omitted).

were regulated by Texas law under both the Texas Insurance Code and the State's antitrust statutes, and did not constitute a "boycott" within the meaning of the McCarran Act. In deciding the issue of whether the Pharmacy Agreement was within the term "business of insurance," the Court found that the Agreement was "based upon the provisions contained in the policies relating to coverage and benefits" and was "simply the performance of the insurer's obligations owed to its insureds under the insurance contract and nothing more." App. A, at 8a. The Court concluded that "the method adopted by Blue Shield of providing benefits under the [p]olicies is closely connected to the relationship between Blue Shield and its insureds." App. A, at 8a. Finally, the District Court held that by virtue of their contractual agreements with Blue Shield, the pharmacy petitioners had become "an integral part of the overall scheme of insurance coverage which is regulated by state law" and that this integration placed them within the "business of insurance." Thus, the Court determined that the pharmacy petitioners were also entitled to the protection afforded by the Act. App. A, at 13a.[3]

The Court of Appeals for the Fifth Circuit reversed, holding that the Pharmacy Agreement did not pertain to the relationship between Blue Shield and its insureds. Despite the District Court's findings that the Pharmacy Agreement is inextricably linked to and in fact required by the policy provisions relating to

[3] Respondents also alleged a pendent state law claim that petitioners violated the Texas antitrust laws, Tex. Bus. & Comm. Code Ann. § 15.01, *et seq.* Upon its dismissal of respondents' federal antitrust claims, the District Court also dismissed the pendent claim for lack of subject matter jurisdiction. App. A, at 14a.

benefits and coverage, the Court of Appeals concluded that "Blue Shield's policyholders are basically unconcerned with the contract between the insurer and the Participating Pharmacy."[4] App. B, at 25a.

REASONS FOR GRANTING THE WRIT

I. The Decision Below Conflicts With The Decisions Of All Other Courts Of Appeals Which Have Interpreted The Term "Business of Insurance" To Include Direct Arrangements Between Insurers And Third Parties For The Performance Of Obligations Owed To Policyholders.

The decision below stands alone and is in direct conflict with every other court of appeals decision which has had occasion to consider whether the "business of insurance" includes an insurer's dealings with third parties to satisfy obligations due to its insureds. It is a clear departure from the well established interpretation of the statutory term "business of insurance." Indeed, the Fifth Circuit frankly acknowledged that "several district courts have rendered decisions contrary to the conclusion we reach today," including "two such cases . . . affirmed on appeal." App. B, at 33a. The two Court of Appeals decisions are those in *Anderson* v. *Medical Service of the District of Columbia,* 551 F.2d 304 (4th Cir. 1977), *aff'g* 1976 Trade Cas. ¶ 60,884 (E.D. Va. 1976), and *Frankford Hospital* v. *Blue Cross of Greater Philadelphia,* 554 F.2d 1253 (3rd Cir.), *cert. denied,* —— U.S. ——, No. 77-171 (Oct. 3, 1977). In *Anderson,* the Court of Appeals held that participating agreements between

[4] Because its decision on the "business of insurance" issue was dispositive, the Court of Appeals found it unnecessary to reach the state regulation and boycott questions decided adversely to respondents in the District Court. App. B, at 22a.

a health care insurer and physicians providing services to insureds were within the "business of insurance"; in *Frankford,* the Court of Appeals rendered a similar decision on agreements between Blue Cross and hospitals providing services to Blue Cross' subscribers.

Recently, still another of the conflicting district court decisions was affirmed on appeal in an opinion which relied heavily on the District Court's opinion in this case. *Proctor* v. *State Farm Mutual Automobile Insurance Co.*, 561 F.2d 262 (D.C. Cir. 1977), *petition for cert. pending,* No. 77-580.[5] In *Proctor,* the plaintiff automobile repair shops brought an antitrust action against automobile insurers alleging that the insurance companies had conspired to pay insureds' claims on the basis of prevailing labor rates and a common formula for computation of damage estimates, and had entered into alleged vertical arrangements to direct business to "preferred" shops and to boycott other shops. The Court of Appeals affirmed the dismissal of the complaint on "business of insurance" grounds, citing the opinion of the District Court in this case approvingly, and noting that the District Court had reached a "similar conclusion with respect to agreements between [a] medical insurance company and 'participating pharmacies,' establishing terms of reimbursement to pharmacies for drugs dispensed to policyholders." 561 F.2d at 268. The de-

[5] As well as raising a "business of insurance" issue, *Proctor* involves the question of whether the McCarran Act's "boycott, coercion, and intimidation" exception permits suits by persons other than insurers and insurance agents. The latter issue is also raised in *Barry* v. *St. Paul Fire & Marine Insurance Co.*, 555 F.2d 3 (1st Cir. 1977), *cert. granted,* No. 77-240.

cision below is squarely in conflict with the holding in *Proctor* that the insurers' determination of the amounts to be paid in fulfillment of its policy obligations was "at the heart of the relationship between insurer and insured, and is directly connected with the reliability, interpretation, and enforcement of the insurance contract." *Id.* at 267.

Yet a fourth conflicting decision is *Travelers Insurance Co.* v. *Blue Cross of Western Pennsylvania,* 481 F.2d 80 (3rd Cir.), *cert. denied,* 414 U.S. 1093 (1973), an antitrust action brought by a private insurer objecting to a standard contract between Blue Cross and hospitals "which prescribes the amounts and terms under which Blue Cross pays for the services rendered its subscribers". 481 F.2d at 82. The Court of Appeals affirmed dismissal of the complaint on McCarran Act grounds, upholding the District Court's determination "that the interrelationship of hospital payments and subscribers' rates was such that Blue Cross' arrangement with hospitals should be considered part of the 'business of insurance.'" *Id.* at 83. The fifth opinion in this series of decisions conflicting with the holding below is *Doctors, Inc.* v. *Blue Cross, of Greater Philadelphia,* 1977-1 Trade Cas. ¶ 61,420 (3rd Cir. 1977), *aff'g* Civil Action No. 73-1057 (E.D. Pa. Aug. 13, 1975), which relied on the *Travelers* decision in determining that contractual agreements between Blue Cross and hospitals constitute the "business of insurance."[6]

[6] The Fifth Circuit sought to distinguish the *Doctors, Inc.*, and *Travelers* decisions because the Pennsylvania State Insurance Commissioner "was exerting pressure on the large insurance companies to exercise their power over hospitals to reduce hospital costs" and because Pennsylvania regulated non-profit hospital rates. App. B,

In short, unlike the Court below, the Courts of Appeals for the District of Columbia, Third and Fourth Circuits all have held that the satisfaction of obligations due the insured, whether by contractual provision of goods and services with reimbursement to the provider or by claims payments to the insured, is at the "core of the 'business of insurance' " as defined by this Court in *National Securities*. 393 U.S. at 460.

The Fifth Circuit's assumption that the pharmacy petitioners are automatically ineligible for McCarran Act immunity also is in direct conflict with the decisions of two other Courts of Appeals which have held that non-insurers may be a part of the "business of insurance" for purposes of the McCarran Act exemption.[7] In *Doctors, Inc., supra,* the Court of Appeals for the Third Circuit affirmed the District Court's dismissal of the complaint as to Blue Cross and a private non-insurance health care and hospital advisory agency found to be within the "business of insurance." In *Lowe* v. *Aarco-American, Inc.,* 536 F.2d 1160 (7th Cir. 1976), the Court of Appeals held that the defendants, an insurance broker and a premium finance company, were engaged in the "business of in-

at 28a. That characterization is based on the erroneous premise that, unless there is state regulation, a company cannot be engaged in the "business of insurance". However, as the McCarran Act explicitly provides, state regulation is a second and independent element in determining whether McCarran immunity is available. The Fifth Circuit below did not consider the District Court's conclusion that Texas had both approved and regulated Blue Shield's drug insurance policies.

[7] The Court below did not examine the relationship of the pharmacy petitioners to the nature of the insurance *coverage* involved, and instead simply stated, without elaboration, that the Act affords no antitrust exemption for the "noninsurance" petitioners. App. B, at 33a.

surance," were regulated by state insurance authorities and thus were exempt from the Truth-In-Lending Act. The Court noted that "[t]here is nothing in the McCarran Act which limits the 'business of insurance' to the business of insurance companies." *Id.* at 1162. Thus, unlike the Court below, the Courts of Appeals for the Third and Seventh Circuits have recognized that the "business of insurance" includes parties engaged in providing services intimately connected to the sale or implementation of insurance policies particularly where, as here, the plan of insurance is regulated by the state. Indeed, this Court stated in *National Securities* that the Act "refers not to the persons or companies who are subject to state regulation, but to laws 'regulating the *business* of insurance.'" 393 U.S. at 459.[8] (Emphasis in original).

II. The Decision Below Jeopardizes The Existence Of Prepaid Health Insurance Plans And Will, Contrary To The Purposes Of The McCarran Act, Preempt State Regulation Of Health Insurance.

By subjecting insurers' contracts with providers of health care services to the antitrust laws, even though such contracts are an inseparable feature of prepaid health policies which are regulated by the states, the decision below threatens the viability of a new and

[8] Moreover, the protection afforded by the Act is expressly extended to, the "business of insurance, *and every person engaged therein.*" 15 U.S.C. § 1012(a). (Emphasis added). Importantly, other areas of antitrust immunity, such as organized labor, *e.g.*, Scooper Dooper, Inc. v. Krafteo Corp., 494 F.2d 840 (3rd Cir. 1974), and regulated industries, *e.g.*, Scroggins v. Air Cargo, Inc., 534 F.2d 1124 (5th Cir. 1976), have been likewise interpreted to afford the exemption to those *dealing with* one entitled to claim antitrust immunity.

growing segment of the health insurance industry. Prepaid health insurance was a response by insurers to the rapid escalation in the cost of health care services and to the urgings of federal and state officials to provide health care delivery systems which are within the financial reach of the general public. Many major health insurance companies now provide plans for physician, dental, hospital, optometric and pharmaceutical goods and services similar in concept to the one here at issue and which also involve third party providers.[9]

Prepaid health insurance obligates the insurer to furnish specified health care services to its insureds in return for premiums paid by them or on their behalf by their employer. In order to carry out its obligations under the policy, the insurer must contract with providers of health care services such as doctors, dentists, hospitals and pharmacists. By negotiating in advance the price of health care services furnished by the provider, insurers are able to offer reduced rates because, in contrast to the unpredictable costs of benefits under traditional health policies, they know the cost of the benefits they will be obligated to provide.

By removing provider agreements from the "business of insurance," the decision below places insurers in the untenable position of being regulated by the states, while simultaneously facing the possibility of

[9] Increasingly, prepaid health insurance has been among the fringe benefits negotiated in union collective bargaining agreements. Indeed, the prepaid prescription drug policies which are the subject of this case were first developed by Michigan Blue Shield pursuant to a collective bargaining agreement between the United Auto Workers and domestic automobile manufacturers.

antitrust litigation brought by providers who have chosen not to enter into participating agreements. The specter of the costs which would be incurred in even meritless litigation and the exposure to treble damages, however remote, will effectively prohibit the implementation of these plans.

The District Court recognized that where health care providers under prepaid insurance policies, such as the pharmacy petitioners here, have agreed to provide the policy benefits to Blue Shield's insureds, those providers "have become an integral part of the overall scheme of insurance coverage which is regulated by state law," and they too are entitled to protection under the Act. App. A, at 13a. Were the law otherwise, an anomolous result would be reached whereby one party, such as Blue Shield, would be free to enter into arrangements such as the Pharmacy Agreement, but there would be no one else who could safely enter into such a contract. The statutory immunity would thus be reduced to a legal fiction, without practical effect.

The decision below also infringes upon the extensive state regulation of health care plans. Substantially all of the states regulate such plans through approval of coverages (as specified in the policies and appurtenant provider agreements), rates, sales and underwriting practices and prohibitions on unfair methods of competition.[10] The application of federal antitrust standards, not specifically designed to deal with insurance availability, coverages and rates, will directly

[10] *See, E.g.*, Cal. Health and Safety Code § 1340, *et seq.* (West Supp. 1977); Mass. Laws Ann., Ch. 176G § 1, *et seq.* (1977); N.Y. Public Health Law § 440, *et seq.* (McKinney Supp. 1977); Pa. Stat. Ann., Title 40, Ch. 6 § 1401 *et seq.* (Purdon 1971).

impair the ability of the states to effectively regulate the business of insurance despite the Congressional declaration contained in the McCarran Act that "the continued regulation and taxation by the several states of the business of insurance is in the public interest." 15 U.S.C. § 1011. The effect of the decision below is to ignore this statutory mandate and to place the federal courts in the position of becoming surrogate insurance commissioners. This new and fundamental question of the manner in which insurers are to provide benefits to insureds at reasonable rates is precisely the type of question that the insurance commissioners of each state are most competent to examine through such administrative procedures as approval of rates and policy provisions. The decision below, however, limits the insurer's function to paying bills and deprives insurers of the ability to negotiate the costs of benefits in order to reduce rates and increase coverages.

If state regulation of the business of insurance is to be subordinated to the federal antitrust laws, it should only be after statutory revision by Congress or upon plenary consideration by this Court.

CONCLUSION

The federal courts are being increasingly burdened with a profusion of antitrust cases involving health insurance plans and provider agreements. Until the decision below, the lower courts have uniformly held such plans and agreements to be part of the "business of insurance," subject to state regulation and thus, absent boycott, beyond the reach of the federal anti-

trust laws.[11] The clear conflict created by the decision below and the uncertainty it engenders makes it appropriate—indeed, necessary—for this Court to delineate the boundaries between federal and state regulation. This Court should resolve the conflict that has now arisen regarding the fundamental threshold question under the Act: what activities constitute the

[11] In addition to the cases previously cited herein, the Fifth Circuit notes that its decision is also in conflict with the decisions in Manasen v. California Dental Services, 424 F. Supp. 657 (N.D. Cal. 1976) (participating dentist agreements); Schwartz v. Commonwealth Land Title Insurance Co., 374 F.Supp. 564 (E.D. Pa. 1974) (rating bureau for title insurance companies immune); Nankin Hospital v. Michigan Hospital Service, 361 F.Supp. 1199 (E.D. Mich. 1973) (participating hospital agreements); and California League of Independent Insurance Producers v. Aetna Casualty & Surety Co., 175 F.Supp. 857 (N.D. Cal. 1959) (commissions paid to agents within the "business of insurance"). Conflicting decisions not mentioned by the Fifth Circuit include St. Bernard General Hospital v. Hospital Service Association of New Orleans, Inc., Civil Action No. 71-2493 (E.D. La., Oct. 13, 1977) (participating hospital agreements); Workman v. State Farm Mutual Automobile Ins. Co., Civil Action No. 75-1799 (N.D. Cal., Sept. 16, 1976) (arrangements between automobile insurer and automobile body repair shops constitute the business of insurance); Winters v. Kansas Hospital Service Ass'n., 1975-1 Trade Cas. ¶ 60,140 at 65,386 (D. Kan. 1974) (hospital agreements); and Holly Springs Funeral Home, Inc. v. United Funeral Service, Inc., 303 F.Supp. 128 (N.D. Miss. 1969) (arrangements for provision of funeral services under burial insurance policies—funeral homes immune).

"business of insurance"? The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A

Opinion of United States District Court for the Western District of Texas, June 23, 1976

ROYAL DRUG COMPANY d/b/a Royal Pharmacy of Castle Hills and Disco Prescription Pharmacy et al.

v.

GROUP LIFE AND HEALTH INSURANCE COMPANY a/k/a Blue Shield and/or Blue Cross-Blue Shield of Texas, et al.

Civ. A. No. SA-75-CA-131.

UNITED STATES DISTRICT COURT,
W. D. TEXAS
SAN ANTONIO DIVISION

June 23, 1976.

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Memorandum Opinion

JOHN H. WOOD, Jr., *District Judge.*

I.

Plaintiffs in this private civil antitrust action are eighteen independent pharmacy owners doing business in San Antonio, Texas. Defendant Group Life and Health Insur-

ance Company, also known as Blue Shield of Texas ("Blue Shield"), is an insurance company duly authorized by the Texas State Board of Insurance to transact the business of life, health and accident insurance within the State of Texas. The remaining three Defendants, Walgreen Texas Co. ("Walgreen"), The Sommers Drug Stores Company ("Sommers"), and Rieger/Medi-Save Pharmacies, Inc. ("Rieger") operate pharmacies in San Antonio, Texas.

Plaintiffs' suit is an attack upon Blue Shield's plan of operation under certain prescription drug insurance policies (the "Policy") which it issues. It is alleged that Defendants have violated Section 1 of the Sherman Act, 15 U.S.C. § 1, by agreeing, combining and conspiring to fix the retail price of drugs and pharmaceuticals, and that the activities of Defendants have caused Blue Shield's insureds not to deal with certain of the Plaintiffs, thereby constituting a group boycott. Plaintiffs further allege that Defendants have violated the Texas antitrust laws, Tex. Bus. & Comm.Code Ann. § 15.01, *et seq.*, and that this Court should exercise pendent jurisdiction over those claims.

Each of the Defendants has separately moved to dismiss the Complaint for lack of jurisdiction over the subject matter and for failure to state a claim upon which relief can be granted. Defendants' motions are based upon the provisions of the McCarran-Ferguson Act, 15 U.S.C. § 1011, *et seq.* The motions also urge that in the absence of any valid cause of action based upon federal law, this Court should dismiss Plaintiffs' pendent claims.

Extensive discovery has been completed on the issue presently before the Court. The record includes numerous depositions, affidavits and documents, and all parties have had full opportunity to present all materials pertinent to Defendants' motions. The Court has carefully reviewed and considered all of those materials, together with the briefs submitted by the parties and the oral argument of counsel.

The facts relevant to Defendants' motions are undisputed. The Policies provide prescription drug insurance coverage. The benefits provided under the Policies entitle Blue Shield's insureds to receive prescription drugs from any pharmacy (a "Participating Pharmacy") that has entered into a written contract (the "Pharmacy Agreement") with Blue Shield. The Policies further provide that the insured is required to pay no more for each prescription filled by a Participating Pharmacy than the amount of the drug deductible set forth in the Policy. The drug deductible is $2.00. Pursuant to the terms of the Pharmacy Agreement, a Participating Pharmacy agrees to dispense drugs to Blue Shield's insureds and to accept $2.00 as full payment from the insured for each dispensed drug. Further, Blue Shield agrees to reimburse the Participating Pharmacy for the acquisition cost of each drug dispensed to its insureds. Under the terms of the Policy, if the insured has his prescriptions filled by a pharmacy other than a Participating Pharmacy, he must pay the full price charged by the pharmacy and then apply to Blue Shield for reimbursement. Blue Shield will then reimburse the insured for 75% of the usual and customary charge for the drug, less the $2.00 deductible.

Walgreen, Sommers and Rieger each own Participating Pharmacies. Blue Shield is not engaged in selling or dispensing prescription drugs as a manufacturer, wholesaler or retailer, but is engaged solely in transacting the business of life, health and accident insurance.

In 1969, Blue Shield sought authority from the Texas State Board of Insurance to begin issuing prescription drug insurance coverage in the form described above. Article 3.42 of the Texas Insurance Code provides that all new policy forms proposed to be issued by life, health and accident insurance companies must be filed with the State Board of Insurance and approved prior to issuance or use by the company. In March, 1969, Blue Shield filed with the

State Board of Insurance a proposed form of the Policy and the Pharmacy Agreement for approval prior to their issuance or use. The terms of the policy provided that Blue Shield's insureds were entitled to receive prescription drugs from Participating Pharmacies (called "participating providers" in the Policy). The Policy defined the term "participating provider" as a pharmacy who "has entered into a written contract [with Blue Shield] for the rendition of covered drugs for which benefits are provided by this [policy]." The Pharmacy Agreement was in the form described above.

In June, 1969, the Commissioner of Insurance issued a written order disapproving the issuance or use of the Policy. The Commissioner also notified the Texas Attorney General in writing of the action taken by the State Board and provided the Attorney General with copies of all pertinent documents. As a result of the disapproval order, Blue Shield did not issue or use the Policy or the Pharmacy Agreement.

Subsequent to the issuance of the disapproval order, the Policy and the Pharmacy Agreement remained under consideration by the State Board of Insurance. In September, 1969, pursuant to Article 3.42(e) of the Texas Insurance Code,* the Commissioner of Insurance issued another written order exempting the Policy from the approval requirements of Tex.Ins.Code Ann. art. 3.42.

The exemption order issued by the Commissioner of Insurance provided, in pertinent part:

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* "The Board of Insurance Commissioners may, by written order, exempt from the requirements of this Article for so long as it deems proper, any insurance document or form specified in such order to which in its opinion this Article may not practicably be applied, or the filing and approval of which are, in its opinion, not desirable or necessary for the protection of the public." Tex. Ins.Code Ann. art. 3.42(e).

"Pursuant to the authority granted by Article 3.42, Paragraph (e) of the Texas Insurance Code, the Commissioner of Insurance hereby exempts from the requirements of said Article Policy Form CC-OHDS-2 submitted by Group Life and Health Insurance Company, Dallas, Texas; and this exemption shall remain effective pending further orders from the Commissioner of Insurance.

"The exempt forms are described as drug service contracts, which confer upon the policy holder the right to obtain certain prescribed drugs at a cost fixed in the contract, the insurer having entered into participating agreements with dispensing pharmacies to supply the prescribed drugs to its policy holders."

It is clear that the exemption order exempted the Policy from nothing more than the requirement of approval by the State Board of Insurance. The former Deputy Commissioner of Insurance, who reviewed the Policy and the Pharmacy Agreement and then prepared the exemption order for the Commissioner's signature, testified on oral deposition that exempted policies are subject to all statutory requirements of the Texas Insurance Code and all regulatory requirements of the State Board of Insurance. He further testified that exempted policies and approved policies are subject to the same continuing regulation, control and supervision by the State Board. Other officials of the State Board of Insurance testified on oral deposition that exempted policies and approved policies are treated alike within the regulatory framework of the State Board of Insurance.

Further, the exemption order clearly shows that the Commissioner of Insurance considered the Pharmacy Agreement together with the Policy prior to issuing the exemption order. The exemption order authorized Blue Shield to issue and use the Policy in the State of Texas in

the same manner as if it had been approved. Subsequent to the issuance of the exemption order, the Commissioner again advised the Texas Attorney General in writing of his action and forwarded a copy of the exemption order to the Attorney General. The exemption order has not been modified or rescinded.

Thereafter, Blue Shield made a statewide mailing to licensed pharmacies offering them the option of entering into the Pharmacy Agreement. Subsequent to the issuance of the exemption order, Blue Shield has issued the policy to various groups and entered into the Pharmacy Agreement with pharmacies throughout the State of Texas.

In 1974, Blue Shield entered into a health care agreement to provide insurance benefits to groups in Bexar County, Texas. Included in the proposed coverage was prescription drug insurance. In September, 1974, pursuant to Tex.Ins.Code Ann. art. 3.42, a Policy form virtually identical to the one submitted in 1969 was filed with the State Board of Insurance for approval prior to issuance or use in connection with the Bexar County program. Thereafter, in October, 1974, the Commissioner of Insurance issued a written order approving the Policy for issuance. Since receipt of the approval order, Blue Shield has issued the Policy to various groups in Bexar County, Texas. Blue Shield offered to virtually all licensed pharmacies in San Antonio, Texas, the opportunity of entering into a Pharmacy Agreement. Nine of the Plaintiffs accepted Blue Shield's offer and now operate Participating Pharmacies.

Plaintiffs agree that Blue Shield is engaged in the business of issuing prescription drug insurance coverage; however, they contend that the McCarran-Ferguson exemption is inapplicable in that Blue Shield has exceeded the business of insurance by entering into the Pharmacy Agreements, and that such agreements have nothing to do with the business of insurance. Plaintiffs further contend that regardless of whether or not Blue Shield is engaged in the

business of insurance, Walgreen's, Sommers' and Rieger's participation in the Pharmacy Agreement is not the business of insurance.

For the reasons set forth herein, this Court does not agree with Plaintiffs' contentions. It is clear that the terms of the Policies which were reviewed by the State Board of Insurance and which it authorized Blue Shield to issue, expressly contemplate the execution of Pharmacy Agreements between Blue Shield and Participating Pharmacies. Moreover, the Pharmacy Agreement is so integrally related to the Policies that it would be impossible for Blue Shield to fulfill its contractual obligations to its insureds in the absence of such agreements.

The McCarran-Ferguson Act provides that ". . . the Sherman Act, . . . the Clayton Act, and the . . . Federal Trade Commission Act . . . shall be applicable to the business of insurance to the extent that such business is not regulated by State law." 15 U.S.C. § 1012(b). To the extent a state regulates such business by state law, the Sherman Act and the other federal antitrust laws are not applicable. The exemption is effective provided that two criteria are met: (1) that the "business of insurance" is involved, and (2) that there is state regulation of the business of insurance. The McCarran-Ferguson Act does not apply to acts of "boycott, coercion or intimidation." 15 U.S.C. § 1013(b).

II.

The Business of Insurance

In *SEC v. National Securities, Inc.*, 393 U.S. 453, 89 S.Ct. 564, 21 L.Ed.2d 668 (1969), the Supreme Court held that the "business of insurance" includes the relationship between the insurer and insured; the type of policy which could be issued, its reliability, interpretation and enforcement; and other activities of insurance companies which closely relate to their status as reliable insurers. *Id.* at 460,

89 S.Ct. 564. The Pharmacy Agreement directly pertains to the relationship between Blue Shield and its insureds. Moreover, the Pharmacy Agreement is a *direct* contractual relationship between the insurer and a provider of benefits, the result of which is simply the performance of the insurer's obligations owed to its insureds under the insurance contract and nothing more. A similar *direct* contractual relationship was examined in *Travelers Ins. Co. v. Blue Cross of West. Pennsylvania,* 481 F.2d 80 (3rd Cir. 1973) *cert. denied,* 414 U.S. 1093, 94 S.Ct. 724, 38 L.Ed.2d 550 (1973). In that case, the Third Circuit held that such contractual arrangements constituted the business of insurance, and thus, the relationship fell within the McCarran-Ferguson exemption. Direct contractual relationships between the insurer and a provider of benefits, as in this case, plainly relate to the "relationship between insurer and insured." The Pharmacy Agreement is based upon the provisions contained in the Policies relating to coverage and benefits, and directly concerns matters of interpretation and enforcement of the Policies. Clearly, the method adopted by Blue Shield of providing benefits under the Policies is closely connected to the relationship between Blue Shield and its insureds. The activities challenged by Plaintiffs in this action, including Blue Shield's contractual arrangements with Participating Pharmacies, constitute the business of insurance within the meaning of *SEC v. National Securities, Inc., supra.*

A program substantially similar in concept and operation to the one at issue was previously determined by the Texas Attorney General to constitute the business of insurance in the State of Texas. In response to a request for an opinion from the Texas Commissioner of Insurance, the Attorney General analyzed a prescription drug program which contemplated the filling of subscriber's prescriptions by participating pharmacies. The plan of operation was based upon a contract between the company and participating pharmacies, whereby the pharmacy agreed to charge

the subscriber no more than a certain percentage of the retail price of the prescription, and the company agreed to reimburse the pharmacy for the remainder. After thoroughly discussing the program the Attorney General concluded that ". . . the plan of operation intended to be followed by Prepaid Prescription Plan, Inc. would involve the doing of an insurance business in this state". Texas Attorney General's Opinion No. WW-1475 (Dec. 11, 1962).

This Court concludes that Blue Shield's plan of operation under the prescription drug insurance Policies, including the Pharmacy Agreements, constitutes the "business of insurance" within the meaning of the McCarran-Ferguson Act.

III.

State Regulation

A. *General Regulation.*

The McCarran-Ferguson Act renders the federal antitrust laws inapplicable when state legislation generally proscribes, permits, or otherwise regulates the conduct in question and authorizes enforcement through a scheme of administrative supervision. *Crawford v. American Title Ins. Co.,* 518 F.2d 217 (5th Cir. 1975); *FTC v. National Cas. Co.,* 357 U.S. 560, 78 S.Ct. 1260, 2 L.Ed.2d 1540 (1958); *Commander Leasing Co. v. Transamerica Title Ins. Co.,* 477 F.2d 77 (10th Cir. 1973).

The State of Texas has actively regulated the activities challenged in Plaintiff's Complaint since the inception of Blue Shield's prescription drug insurance program. The requirement of Article 3.42 of the Texas Insurance Code that all policy forms must be filed for review and approval by the State Board of Insurance prior to issuance or use by the insurer was fully satisfied. Active regulation of the prescription drug insurance program is further shown by the written orders issued by the Commissioner of Insurance and by the fact that the Texas Attorney General was

also kept fully advised of Blue Shield's prescription drug insurance program.

B. *Regulation Of Unfair Methods Of Competition In The Business of Insurance.*

Not only is there a scheme of general state regulation of the business of insurance involved in this action, but the Texas Insurance Code contains specific provisions applicable to the conduct alleged in Plaintiffs' Complaint. In 1951, the Texas Legislature enacted Tex.Ins.Code Ann. art. 21.21, which expressly regulates unfair competition and unfair practices in the business of insurance. The declaration of purpose of the Act states:

> "The purpose of this Act is to regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945 (Public Law 15, 79th Congress) [the McCarran-Ferguson Act], by defining, or providing for the determination of, all such practices in this state which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined." Tex.Ins.Code Ann. art. 21.21 § 1.

Article 21.21 specifically prohibits "*any* trade practice which is defined in [the] Act as, or determined pursuant to [the] Act to be, an unfair method of competition or unfair or deceptive act or practice in the business of insurance." Tex.Ins.Code Ann. art. 21.21 § 3. (Emphasis added) That statute grants specific administrative and supervisory powers to the State Board of Insurance, including the power to issue cease and desist orders. Penalties are provided for violation of such orders. Without doubt, the phrase "any" unfair method of competition encompasses the conduct challenged in this action. Furthermore, the oral deposition testimony establishes that the State Board of Insurance reviews all policy forms submitted to it with a view toward

insuring compliance with Article 21.21, and that approved, as well as exempted policies, are subject to its provisions. Article 21.21 was specifically intended by its drafters to respond to the invitation of the McCarran-Ferguson Act and to withdraw from federal control the very conduct charged by Plaintiffs in this action, and to place such conduct under state control. Article 21.21 constitutes sufficient state regulation to activate the exemption provided in the McCarran-Ferguson Act. *Crawford v. American Title Ins. Co.*, 518 F.2d 217 (5th Cir. 1975); *Dexter v. Equitable Life Assurance Soc'y of the U. S.*, 527 F.2d 233 (2nd Cir. 1975).

C. *The Texas Antitrust Laws.*

In addition to the comprehensive regulation of Blue Shield's activities provided by the Texas Insurance Code, anticompetitive practices in the business of insurance are also regulated by the Texas antitrust laws. The Texas antitrust laws declare categorically that "[e]very monopoly, trust, and conspiracy in restraint of trade . . . is illegal and prohibited." Tex.Bus. & Comm. Code Ann. § 15.04(a). Further, the Texas antitrust laws specifically prohibit conspiracies of the type alleged in Plaintiffs' Complaint. Tex. Bus. & Comm.Code Ann. § 15.02. It should be noted that Plaintiffs have included in their Complaint a pendent claim under the Texas antitrust laws based upon the same facts that Plaintiffs allege give rise to a violation of the federal antitrust laws.

The existence of a state antitrust law proscribing the conduct complained of constitutes "regulation" within the meaning of the McCarran-Ferguson Act sufficient to displace the federal antitrust laws. *Meicler v. Aetna Cas. and Sur. Co.*, 506 F.2d 732 (5th Cir. 1975); *Sanborn v. Palm*, 336 F.Supp. 222 (S.D.Tex.1971); *Transnational Ins. Co. v. Rosenlund*, 261 F.Supp. 12 (D.Ore.1966); *California League of Ind. Ins. Producers v. Aetna Cas. & Sur. Co.*, 175 F.Supp. 857 (N.D.Cal.1959).

Therefore, in addition to active regulation under the Texas Insurance Code, the existence of state antitrust statutes forbidding the conduct alleged by Plaintiffs constitutes state regulation of the business of insurance sufficient to bar application of the federal antitrust laws.

IV.

The Boycott Exception to the McCarran-Ferguson Act Is Inapplicable

As in *Meicler v. Aetna Cas. and Sur. Co., supra,* Plaintiffs attempt to avoid the effect of the McCarran-Ferguson exemption by relying on the Section 1013(b) boycott exception. Plaintiffs' reliance on this exception is misplaced. The courts have narrowly construed Section 1013(b), which provides:

> "Nothing contained in this chapter shall render said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion or intimidation." 15 U.S.C. § 1013(b).

The sole purpose of this exception is to protect against the issuance of black-lists naming insurance companies or agents, rather than the conduct alleged by Plaintiffs in this action.

In *Meicler*, the Court stated:

> "As the district court noted, the legislative history indicates that the boycott exception was designed to reach insurance company 'black-lists' rather than refusal to sell to a particular segment of the public at other than a specified price. (Citations omitted) Appellants' broad construction of Section 1013(b) would emasculate the antitrust exemption contained in Section 1012(b) of the McCarran-Ferguson Act. We affirm the district court's holding that the boycott exception does not apply." 506 F.2d at 734.

This case does not involve black-listing and the boycott exception is inapplicable. *Addrisi v. Equitable Life Ins. Assurance Soc'y of the U. S.,* 503 F.2d 725 (9th Cir. 1974); *Proctor v. State Farm Mut. Auto Ins. Co.,* 406 F.Supp. 27 (D.D.C.1975); *Mitgang v. Western Title Ins. Co.,* Trade Reg.Rep. (1974-2 trade cases) ¶ 75,322 at 98,024 (N.D.Cal. October 16, 1974); *Transnational Ins. Co. v. Rosenlund,* 261 F.Supp. 12 (D.Or.1966).

V.

Application of the McCarran-Ferguson Act to the Non-Insurance Company Defendants

Plaintiffs contend that Walgreen, Sommers and Rieger are not entitled to the protection afforded by the McCarran-Ferguson Act because they are not insurance companies. The exemption provided in the Act is not strictly limited to insurance companies. As shown herein, it is the "business of insurance" with which the Act is concerned.

Recent cases have allowed the exemption even though the challenged activities involved parties other than insurance companies. In *Travelers Ins. Co., v. Blue Cross of West. Pennsylvania,* 481 F.2d 80 (1973), the Court applied the exemption to contracts between the insurance company and hospitals. In *Schwartz v. Commonwealth Land Title Ins. Co.,* 374 F.Supp. 564 (E.D.Pa. 1974), the exemption was applied to a fee charged to sellers of real estate by title insurance companies and agents.

It is clear that it is the nature of the conduct involved which must be looked at in order to determine whether or not the exemption should be applied. In the instant case, Walgreen, Sommers and Rieger, by having contractually agreed with Blue Shield to provide the benefits set out in the Policy, have become an integral part of the overall scheme of insurance coverage which is regulated by state law. Such integration of the providers of benefits under the

Policies into the overall scheme places their actions under the Pharmacy Agreements within the "business of insurance", and they are therefore entitled to the protection afforded by the McCarran-Ferguson Act for it is clear that one cannot be brought within the web of potential liability under the Federal Antitrust laws for participation in the complained of activity if such activity is, as in the instant case, exempt by operation of the McCarran-Ferguson Act.

VI.

Plaintiff's Pendent Claims

As shown above, the complained of activities are exempt from the Federal Antitrust laws because of the McCarran-Ferguson Act. It is clear from the pleadings on file that jurisdiction over this action does not exist by reason of diversity of citizenship. If the Federal claims are dismissed prior to trial, it is within the ambit of this Court's discretion to decline to continue to exercise jurisdiction over the pendent state claims. No unusual circumstances are present in this case which would require the Court to retain jurisdiction over the pendent claims. *United Mine Workers of America v. Gibbs,* 383 U.S. 715, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966); *Lazier v. Weitzenfeld,* 505 F.2d 896 (5th Cir. 1975); *Kavit v. A. L. Stamm & Co.,* 491 F.2d 1176 (2nd Cir. 1974).

VII.

Conclusion

For the reasons set forth above, this Court concludes that the complained of activities constitute the "business of insurance". This Court further concludes that the State of Texas has regulated and is actively and effectively regulating such business of insurance within the meaning of the McCarran-Ferguson Act, and the Federal Antitrust laws are thereby rendered inapplicable. Accordingly, Defend-

ants' motions will be granted. As shown herein, this Court has considered matters outside the pleadings in arriving at its decision. In doing so, the essentials necessary to support the exemption have been found to exist. Therefore, it is appropriate that Defendants' motions shall be treated as Motions for Summary Judgment and disposed of as provided in Rule 56, Federal Rules of Civil Procedure. The foregoing Memorandum Opinion constitutes the Court's Findings of Fact and Conclusions of Law.

An Order consistent with the foregoing will be entered.

APPENDIX B

Opinion of United States Court of Appeals for the Fifth Circuit, August 8, 1977

ROYAL DRUG COMPANY, INC., d/b/a Royal Pharmacy of Castle Hills and Disco Prescription Pharmacy, et al., *Plaintiffs-Appellants,*

v.

GROUP LIFE AND HEALTH INS. Co., a/k/a Blue Shield and/or Blue Cross-Blue Shield of Texas, et al., *Defendants-Appellees.*

No. 76-2746.

UNITED STATES COURT OF APPEALS, FIFTH CIRCUIT.

Aug. 8, 1977.

Rehearing and Rehearing En Banc Denied Oct. 27, 1977.

* * *

Joel H. Pullen, Stephen F. Lazor, San Antonio, Tex., for plaintiffs-appellants.

Keith E. Kaiser, R. Laurence Macon, J. Burleson Smith, San Antonio, Tex., for Group Life & Health.

William C. Church, Jr., San Antonio, Tex., for Walgreen Texas Co.

Richard B. Moore, San Antonio, Tex., for Sommers Drug Stores Co.

Charles R. Shaddox, San Antonio, Tex., for Rieger-Medi-Save Pharmacies, Inc.

Appeal from the United States District Court for the Western District of Texas.

Before GOLDBERG and HILL, Circuit Judges, and KERR,* District Judge.

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* Senior District Judge for the District of Wyoming, sitting by designation.

JAMES C. HILL, Circuit Judge:

The plaintiffs in this civil antitrust action are eighteen independent pharmacy owners doing business in San Antonio, Texas.[1] Blue Shield is a Texas insurance company authorized by the State Board of Insurance of Texas to sell life, health and accident insurance. Three other defendants, Walgreen Texas Company, The Sommers Drug Stores Company and Rieger Medi-Save Pharmacies, Inc., also operate pharmacies in San Antonio, Texas.

The plaintiffs contend that the defendants have violated Section 1 of the Sherman Act, 15 U.S.C. § 1, by agreeing, combining and conspiring to fix the retail price of drugs and pharmaceuticals, and that the activities of the defendants have caused Blue Shield's insureds not to deal with certain of the plaintiffs, thereby constituting an unlawful group boycott. Plaintiffs also allege violations of Texas antitrust law over which the district court took pendent jurisdiction. The defendants affirmatively alleged in their answers that pursuant to the provisions of the McCarran-Ferguson Act, 15 U.S.C. § 1011, *et seq.*, ("McCarran Act") the complaint failed to state a claim upon which relief could be granted and that the district court lacked subject matter jurisdiction. On the basis of the McCarran Act, each defendant moved to dismiss the complaint pursuant to Rule 12(b), F.R.Civ.P. The defendants also moved that the court treat their motions as motions for summary judgment pursuant to Rule 56, F.R.Civ.P. Defendants further moved the court to dismiss the claims based upon state law if the court found there was not a proper cause of action based upon federal law. The district court held that: (1) the conducted complained of by

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[1] Since the parties have been referred to in the briefs as plaintiffs and defendants, as they were in the district court, they will be so designated in this opinion. The defendant Group Life & Health Insurance Company will be referred to herein as Blue Shield.

the plaintiffs constitutes the business of insurance; (2) the State of Texas has regulated and is actively regulating such business of insurance within the meaning of the McCarran Act; (3) that the boycott exception to the McCarran Act is inapplicable to the instant case; and (4) that the federal antitrust laws are, therefore, rendered inapplicable. We reverse.

I. *The Facts.*

Plaintiffs are challenging a plan of operation under which Blue Shield issues certain prescription drug insurance policies which entitle Blue Shield's insureds to purchase drugs from any pharmacy. If the pharmacy selected by the policyholder has entered into a written contract ("Pharmacy Agreement") with Blue Shield, the insured is required to pay only two dollars ($2.00), the amount of the drug deductible set forth in the policy. On the other hand, if the insured has his prescription filled by a pharmacy other than a Participating Pharmacy, he is required to pay the full price charged by the pharmacy as well as the $2.00 deductible, and then to apply to Blue Shield for reimbursement. Blue Shield will then reimburse the insured only for 75 percent of the usual and customary charge for the drug, less the $2.00 deductible.[2]

In 1969, Blue Shield sought approval from the Texas State Board of Insurance to begin issuing prescription drug insurance coverage. The Commissioner, however, disapproved the issuance or use of such a policy. The policy remained under the consideration of the Commissioner and in September, 1969, the Commissioner issued an order exempting the policy from the approval requirements of Texas law. The defendants contend that there is uncontradicted evidence showing that an exemption order exempts the policy from nothing more than the require-

[2] The usual and customary charge is established by Blue Shield and is determined by reference to its compilation of such charges.

ment of approval by the State Board of Insurance, and that exempted policies, as well as approved policies, are subject to all statutory requirements of the Texas Insurance Code and the continuing regulation, control and supervision of the State Board of Insurance.

When the Commissioner issued his orders concerning the plan, disapproving it in the first instance, and then exempting the plan, he advised the Texas Attorney General in writing of his actions on each occasion. After receiving the exemption order, Blue Shield made a statewide mailing to licensed pharmacies offering them the privilege of entering into the Pharmacy Agreement. As a result, Blue Shield has issued the policy to various groups and has entered into the Pharmacy Agreemnt with pharmacies throughout the State of Texas.

In 1974, Blue Shield entered into a health care agreement, which included a prescription drug insurance, to provide insurance benefits to groups in Bexar County, Texas. In order to implement this agreement, in September, 1974, a policy form virtually identical to the one submitted in 1969 was filed with the State Board of Insurance for approval prior to its issuance or use. This policy was approved in October, 1974. Subsequently, Blue Shield has issued the policy to various groups in Bexar County and has offered to virtually all licensed pharmacies in San Antonio the opportunity of entering into the Pharmacy Agreement. Nine of the plaintiffs in this case accepted Blue Shield's offer and now operate Participating Pharmacies. In recent years, the number of pharmaceutical sales covered by this policy have risen dramatically. For example, between early 1972 and October, 1975, there was a 3,100 percent increase in the number of pharmaceutical claims processed by Blue Shield under the policy. In October, 1975, Blue Shield was handling these claims at the rate of approximately 31,000 claims per month as compared with only 1,000 claims per month in early 1972.

For each sale made under the plan, a Participating Pharmacy is limited to a $2.00 markup, which is known as a "professional dispensing fee," irrespective of its actual acquisition cost for a particular drug. The plaintiffs note that, with respect to highly expensive drugs, the Pharmacy Agreement can result in a markup of no more than two percent, which will not even cover the interest on its investment inventory.

II. *Summary of Contentions on Appeal.*

The plaintiffs argue that the retail sales price, as fixed in the Pharmacy Agreement between Blue Shield and the defendant pharmacy chains, has been set at a level below that at which small independent pharmacies can profitably conduct business. They claim that only large, high volume chains that sell many items in addition to drugs can afford to operate pursuant to the Pharmacy Agreement. They also contend that the Agreement fixes the retail price of drugs at a level which eliminates the only effective means by which small independent pharmacies can compete with the large chains—the provision of services. They argue that, since signatories of the Pharmacy Agreement are limited to the same retail sales price whether they provide home deliveries, twenty-four service, or no service at all, the ability of the independents to compete is effectively destroyed. The plaintiffs contend that Blue Shield's plan of operation not only encompasses the fixing of prices in the defendant pharmacy chains, but it extends to the pharmaceutical industry as a whole. They contend that small independent pharmacies are given the choice of either signing the price fixing agreement or being forced out of business.

The plaintiffs also argue that there are two types of coercion of Blue Shield's subscribers inherent in the plan. First, the subscriber received markedly reduced benefits if he patronizes a pharmacy that refuses to sign the price-

fixing agreement. Although he would pay only the $2.00 drug deductible for each prescription filled by a participating pharmacy, he would ultimately pay an amount representing 25 percent of a reasonable charge for the drug, in addition to the $2.00 drug deductible, for each prescription filled by a nonsigning pharmacy. The plaintiffs also point out that the differential in benefits between participating and nonparticipating pharmacies is intended to coerce Blue Shield's policy holders not to patronize nonsigning pharmacies *in Texas* and thereby to coerce such pharmacies to sign the price-fixing agreement. This allegation is based on the policy itself, which provides that the subscriber will be reimbursed 100 percent of a reasonable charge for the drug, less the $2.00 drug deductible, when he patronizes a nonsigning pharmacy outside the State of Texas.

The plaintiffs also contend that there is a second and more subtle step to the coercion. If a pharmacy signs the Pharmacy Agreement and agrees to charge only the stipulated amount for drugs sold to Blue Shield subscribers, it will be reimbursed directly by Blue Shield in the amount of the acquisition cost, and the subscriber will be obligated to pay the pharmacy at the time of purchase only the $2.00 drug deductible. If the pharmacy has refused to sign the Agreement, however, Blue Shield will not deal with the pharmacy directly, and the subscriber must pay the entire retail sales price at the time of purchase, in addition to the $2.00 fee. After paying the entire sales price at the time of purchase, he must file a claim with Blue Shield seeking reimbursement. Thus, an insured has the additional burden of filing a claim for reimbursement, and he must accept reduced benefits in order to patronize the drug store of his choice.

Having made the above claims, the plaintiffs are immediately confronted with defendant's argument that its activities are exempt from the antitrust laws by virtue of

the McCarran Act. The McCarran-Ferguson Act provides that the Sherman Act, the Clayton Act and the Federal Trade Commission Act shall be applicable to the business of insurance only "to the extent that such business is not regulated by state law."

Disputing the applicability of the McCarran Act exemption, the plaintiffs contend that a three-step analysis is necessary to determine whether an insurance company's challenged activities fall within the Act's exemption. First, they contend, the court must determine whether the challenged activities constitute the "business of insurance." Second, it must determine whether the activities in question are regulated by state law. Third, the court must determine the presence or absence of boycott, coercion, or intimidation.[3] The latter requirement derives from Section 3(b) of the McCarran Act, which states as follows: "Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate or act of boycott, coercion or intimidation." 15 U.S.C. §1013(b) (1970).

III. *Do the Defendants' Activities Constitute the Business of Insurance?*

The stepping off point of our analysis is the general principle that statutory exceptions to the antitrust laws "are to be strictly construed." *Abbott Labs v. Portland Retail Druggists Ass'n, Inc.*, 425 U.S. 1, 96 S.Ct. 1305, 47 L.Ed.2d 537 (1976); *FMC v. Seatrain Lines, Inc.*, 411 U.S. 726, 93 S.Ct. 1773, 36 L.Ed.2d 620 (1973). The notion

[3] A negative finding for the first question obviates the necessity for a determination with respect to the second and third steps, and precludes application of the McCarran Act. *SEC v. Nat'l Securities, Inc.*, 393 U.S. 453, 89 S.Ct. 564, 21 L.Ed.2d 668 (1969); *American General Insurance Co. v. FTC*, 359 F.Supp. 887 (S.D. Tex. 1973), *aff'd.*, 496 F.2d 197 (5th Cir. 1974).

that "our cases have repeatedly established . . . a *heavy presumption against* implicit [antitrust] exemptions" was recently reaffirmed in *Abbott Labs, supra.*[4] Moreover, it is clear that merely because challenged conduct has been engaged in by an insurance company does not dictate its characterization as the "business of insurance" under the McCarran Act. *SEC v. National Securities, Inc.*, 393 U.S. 453, 89 S.Ct. 564, 21 L.Ed.2d 668 (1969). The question presented under the McCarran Act, therefore, "is whether the activities complained of, *even though they may be actions taken by an insurance company,* are part of the 'business of insurance' which Congress sought to remove from federal regulation." *Fry v. John Hancock Mutual Life Ins. Co.*, 355 F.Supp. 1151, 1153 (N.D.Tex.1973) (emphasis added).

In *National Securities* the Supreme Court held that the "business of insurance" included (1) "the relationship between insurer and insured," (2) "the type of policy which could be issued, its reliability, interpretation and enforcement;" (3) "other activities which relate . . . to their status as reliable insurers." Relying on the first of these definitions, the plaintiffs note that the McCarran Act's focus is on the relationship between the insurer and the insured. The plaintiffs argue that a crucial determination is the question how closely the challenged activity concerns the relationship between the insurance company and the policyholder. The activities challenged herein, according to the plaintiffs, relate primarily to relationships other than that between the insurer and its policyholders and therefore are not peculiar to the insurance industry. The plaintiffs concede that there may be effects on policyholders resulting from the Pharmacy Agreement, but they

[4] Relying on this general principle, plaintiffs argue that if the challenged activities do not clearly constitute the business of insurance, they fall outside the McCarran Act's protective umbrella and are subject to the full force and effect of the antitrust laws.

minimize these as peripheral and secondary to the effects on the relationships between competing pharmacies and between such pharmacies and their customers.

The defendants contend, and the district court found, that the plan of operation followed by Blue Shield, including the Pharmacy Agreement, relates directly to its status as a reliable insurer. We cannot agree. It is beyond peradventure that every action taken by an insurance company to enhance its status as a "reliable insurer" does not necessarily constitute the "business of insurance" within the meaning of the McCarran Act. Moreover, an agreement which does not otherwise constitute the business of insurance is not automatically embraced within the protection of the McCarran Act simply because it benefits policyholders either directly, or indirectly by strengthening the financial condition of the insurer.

Defendants allege that the contractual arrangements between Blue Shield and Participating Pharmacies require nothing more than the performance of obligations owed to Blue Shield's insureds under the drug insurance policies. In concluding that "[t]he Pharmacy Agreement directly pertains to the relationship between Blue Shield and its insureds" the district court held that the Pharmacy Agreement "is simply the performance of the insurer's obligations owed to its insureds under the insurance contract and nothing more." Despite these characterizations of the contractual arrangement, we find that the agreements between Blue Shield and Participating Pharmacies do not require Blue Shield to fix prices or to produce other anticompetitive effects in the pharmaceutical industry. Blue Shield's sole obligation is to see that the insured receives prescription drugs and "shall be required to pay no more than the drug deductible for each of such covered drugs." It is unnecessary for Blue Shield to agree with pharmacies to fix retail sales prices in the pharmaceutical industry. Blue Shield's policyholders are

basically unconcerned with the contract between the insurer and the Participating Pharmacy. They are obligated to pay a Participating Pharmacy two dollars ($2.00) for a prescription regardless of the presence or absence of a price fixing arrangement. Thus, by minimizing costs and maximizing profits, the Participating Pharmacy Agreements inure principally to the benefit of Blue Shield.

The plaintiffs attempt to illustrate by example that the relationship primarily affected by the Pharmacy Agreement and the alleged coercion is that between competing pharmacies and not the relationship between insurer and insured. If the challenged activities in this case are held to constitute the business of insurance, they contend, then automobile insurers will be able to utilize Participating Repair Shop Agreements and coercion to fix prices for parts and labor in the automobile industry. Similarly, they contend that fire insurance companies would be able to execute Participating Construction Company Agreements and thereby combine and conspire with large construction companies to set prices for the repair and rebuilding of homes or buildings damaged by fire. The plaintiffs contend that Congress never intended that the McCarran Act be utilized to shield such activities from application of the federal antitrust laws. They note that Congress, in enacting the McCarran Act, may have condoned state supervised rate setting, but Congress was opposed to private price fixing and did not intend that such activity be shielded from federal scrutiny.

The defendants argue that the Pharmacy Agreement is so inextricably intertwined with the policies that it would be impossible for Blue Shield to fulfill its contractural obligations to its insureds in the absence of such agreements with the pharmacies. The defendants also dispute plaintiffs' arguments that if Blue Shield's activities are permitted, automobile insurers will utilize Participating Repair Shops and fire insurance carriers will enter into

Participating Construction Company Agreements. The defendants contend that the types of insurance referred to by the plaintiffs are not at issue here and such types of insurance are regulated by the provisions of the Texas Insurance Code which are not similar to the ones involved in this case. They also contend that Blue Shield was statutorily required to submit the policies to the state board prior to issuance or use and that the Commissioner authorized the use of the policy and Pharmacy Agreement. Finally, they contend that the activities suggested in the hypothetical examples would require careful examination of the existing laws and regulatory devices relating to automobile insurance and fire insurance. In short, they contend that these hypotheticals are nothing more than speculation and conjecture.

We conclude that Blue Shield is no more obligated to fix the retail prices of pharmaceuticals than an automobile insurer is obligated to its insureds having deductible policies to fix the prices charged for parts and labor. Just as the automobile insurer is obligated to pay the cost of repair, whatever it might be, over and above the applicable policy deductible, Blue Shield is obligated to pay the cost of prescription drugs over and above the two dollar ($2.00) drug deductible. Even though an automobile insurer might be able to guarantee by contract that repairs are done for its customers on a "cost" basis, thereby achieving increased profits or reduced rates, such agreements do not thereby become immune from antitrust scrutiny. *Contra, Proctor v. State Farm Mutual Insurance Co.*, 406 F.Supp. 27 (D.D.C.1975).

The plaintiffs next contend that the Pharmacy Agreement produces results far beyond the simple performance of Blue Shield's responsibilities owed to its insureds under The Prescription Drug Insurance Policy. Blue Shield itself may have recognized that the Pharmacy Agreement goes beyond its obligations under the prescription plan.

The plaintiffs introduced into evidence a letter between two Blue Shield executives which indicated a concern over antitrust problems and suggested that the company camouflage the price fixing arrangement as a "mass accounting agreement." The evidence introduced in the trial court stated as follows: "I think it would be best to draft the contract so that the Insurance Board would require filing of the mass accounting agreement [Pharmacy Agreement] to strengthen your base on anti-trust. Drafting problems will get sticky here, but let's pass on that for now." The plaintiffs contend that this letter carries the Blue Shield plan far beyond the protection of the McCarran Act. They contend that Congress did not contemplate or intend that the McCarran Act should shield from antitrust scrutiny any insurance company's efforts to control the magnitude of its policyholder's claims through the elimination of price and other forms of competition in the industries providing goods and services covered by the insurance policy. Since these activities are not regulated by the State, they contend that the McCarran Act exemption does not apply.

We find that the Pharmacy Agreement goes beyond Blue Shield's obligation as an insurer and places the firm in the business of providing products and services. Blue Shield has agreed to provide protection against the risk that a policyholder will require pharmaceuticals. In order to meet that obligation, Blue Shield is not required to guarantee the provision of services on a "cost-plus" basis or any other basis which might be more economical than the retail purchase of such products. That Blue Shield may wish to protect itself and its customers from rising costs in the pharmaceutical industry does not transform the Pharmacy Agreement into the business of insurance. In fact, the best way for the firm to protect itself from rising costs is to establish and periodically adjust its rate structure to reflect the impact of inflation. Such measures, which are by no means foreign to the insurance business,

involve far less intrusion into the pharmaceutical industry and, consequently, avert the potentially anticompetitive effects alleged here.

The plaintiffs next attempt to come to grips with *Travelers Insurance Company v. Blue Cross,* 481 E.2d 80 (3rd Cir.), *cert. denied,* 414 U.S. 1093, 94 S.Ct. 724, 38 L.Ed.2d 550 (1973), by arguing that the McCarran Act does not apply *ipso facto* to every direct contractual relationship between an insurance company and a provider of benefits. In *Travelers,* the Third Circuit held that the contractual arrangements consummated between Blue Cross and various hospitals for the furnishing of services under insurance policies constituted the business of insurance and, thus, the relationship fell within the McCarran Act exemption. There, as here, the relationship was a direct contractual relationship the result of which was the performance of obligations owed to the insured by the insurer on an economically favorable basis. The plaintiffs have attempted to distinguish *Travelers* by arguing that the Third Circuit was merely approving the actions of the Insurance Commissioner of Pennsylvania who was exerting pressure on the large insurance companies to exercise their power over hospitals to reduce hospital costs. This interpretation, with which we agree was adopted in *Doctors, Inc. v. Blue Cross,* 431 F.Supp. 5 (E.D.Pa. 1975), *aff'd per curiam,* 557 F.2d 1001 (3d Cir. 1976).[5] Moreover,

[5] The court indicated the narrow scope of *Travelers* as follows:

> It is therefore readily apparent from the reading of the *Travelers* case that the Third Circuit is approving the *actions of the Insurance Commissioner of Pennsylvania when he exerts pressure* on the large insurance companies to get them to exercise their power over hospitals to force the hospitals to cut costs wherever possible. This is exactly what Blue Cross was doing in our case at the bequest of the Insurance Commissioner. Therefore, since the McCarran-Ferguson exemption was applicable in Travelers . . ., I hold today that the McCarran-Ferguson exemption is applicable in *Doctors, Inc.* . . . *Doctors, Inc. vs. Blue Cross,* 431 F.Supp. 5, 10 (E.D.Pa.1975), *aff'd* 557 F.2d 1001 (3d Cir. 1976) (emphasis added).

the *Travelers* decision was based in large measure on the Pennsylvania legislature's control over rates charged by non-profit hospitals. That regulation was undertaken pursuant to a statutorily created interrelationship between the rates charged by nonprofit health insurers and nonprofit hospitals, which interrelationship was to be regulated by the Pennsylvania Insurance Department. The plaintiffs note that the Texas Legislature has not chosen indirectly or directly to control the rates charged by pharmacies either by directing and controlling contracts between insurers and pharmacies or by creating an interrelationship between the rates charged by pharmacies and those charged by insurers. Since *Travelers* held simply that the contract between a nonprofit health insurer and a nonprofit hospital was shielded by the McCarran Act from attack, *Travelers* carries little precedential value in this appeal.

Rather, the instant case is more nearly akin to *Battle v. Liberty Nat'l Life Ins. Co.,* 493 F.2d 39 (5th Cir. 1974), *cert. denied,* 419 U.S. 1110, 95 S.Ct. 784, 42 L.Ed.2d 807 (1975). In *Battle* several funeral homes and directors brought suit against an insurer, which issued burial policies, and the insurer's wholly owned subsidiary which supplied merchandise and services required by the insurer's policies. Although this court found coercion with respect to the insurer's discrimination in benefits, the court felt that the facts were inadequately developed to make a conclusive determination on the McCarran Act issue. Nonetheless, the court stated as follows: "[I]t might be plausibly argued that these facts do not constitute the business of insurance as contemplated by the McCarran Act and thus do not fall

within its exemption.''[6] The court noted that the obligations under the insurer's arrangement might be related to the business of insurance, but the obligations were so remotely related as to be subject to the antitrust laws. Relying on *Battle,* the plaintiffs argue that the defendants' activities challenged herein are not peculiar to the insurance industry and are not the business of insurance. They argue that by providing markedly decreased benefits to those subscribers who patronize a nonparticipating pharmacy, Blue Shield intentionally and overtly coerces its subscribers to boycott these pharmacies. Not only does this boycott operate to coerce the nonsigning pharmacies to participate in the plan, it also forecloses nonsigning pharmacies from a significant portion of the market and secures for participating pharmacies the sales of prescription drugs required by Blue Shield's claimants. Since this activity is not peculiar to the insurance industry, plaintiffs argue that it does not constitute the business of insurance. As in *Battle*, the contractual agreements here under review are somewhat related to the business of insurance. The relationship, however, is so attenuated that it must be subject to the antitrust laws. As the plaintiffs have so well articulated, ''it is not the office of the insurance industry to set the prices in the various sectors of our economy so that insurers will enjoy an added measure of control over the magnitude of individual claims.''

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[6] The Court stated:

> It appears that, since the insurance contract confers far more benefits upon the policyholder if he uses an authorized funeral home, the policyholder is subtly coerced into dealing only with the authorized home. The imposition of this restraint would effectively foreclose the unauthorized funeral director's access to a substantial portion of the market. 493 F.2d at 44-45.

The court held that these facts ''if established, would tend to support a finding of unreasonable restraint of trade.''

493 F.2d at 44.

The plaintiffs next take issue with the finding of the district court that a 1962 Opinion of the Texas Attorney General has concluded that the challenged activity constitutes the business of insurance. The court read the 1962 Opinion as a determination by the Texas Attorney General that a plan ''substantially similar'' to Blue Shield's plan constituted the business of insurance. Plaintiffs contend that the Attorney General's Opinion held only that the particular firm in question was an insurance company and not that a program substantially similar to Blue Shield's constituted the business of insurance. The plaintiffs allege that the Attorney General's Opinion was based strictly on the facts presented and that it bears no logical relevance to the question whether the activities challenged in this suit constitute the business of insurance. Although the 1962 opinion is not without ambiguity, it appears to focus on the status of the company itself; it does not conclusively establish whether the State considers a plan such as Blue Shield's Pharmacy Agreement to constitute ''the business of insurance.'' Thus, we are compelled to eschew the heavy weight usually given a state's determination that an activity constitutes the ''business of insurance'' in favor of the interpretation given the term by the federal courts. *See SEC v. Variable Annuity Co.,* 359 U.S. 65, 69, 79 S.Ct. 618, 3 L.E.2d 640 (1959).

The State has shed very little light on this matter since the 1962 Attorney General's Opinion discussed above. Although the plaintiffs argue that the State Board of Insurance does not consider The Pharmacy Agreement to encompass or constitute the business of insurance, it is by no means clear that the State has even considered the question. The district court concluded that ''[t]he State of Texas has actively regulated the activities challenged in plaintiff's complaint since the inception of Blue Shield's Prescription Drug Insurance Program.'' (emphasis added). Plaintiffs contend that the State uses the word ''program'' loosely in that the Board of Insurance approved nothing more than

the insurance policy itself and it did not consider the Pharmacy Agreement, which is at issue in this case.

It is clear from the record that the Board has never approved the Pharmacy Agreement, and the Division Manager of the Board's Policy Approval Division, a Mr. Pogue, testified that he thought the Pharmacy Agreement was outside of the State's regulatory control. He stated as follows: "I do not feel that a contract of that nature falls within the jurisdiction of the State Board of Insurance." Plaintiffs argue that the Pharmacy Agreement does not fall within the jurisdiction of the State Board of Insurance simply because it does not constitute the business of insurance.

There is some testimony which contradicts the testimony of Mr. Pogue. A former employee of the State Board of Insurance, a Mr. Connor, gave an arguably contradictory response to what the plaintiffs describe as a "convoluted question" concerning the exemption of Blue Shield's Prescription Drug Insurance Policy form. With respect to this exemption, the following exchange took place between counsel for Blue Shield and Mr. Connor:

> Q. [By Mr. Kaiser] . . . Mr. Connor, at the time of the issuance of this Exemption Order that you are looking at right now, was it your opinion that this particular contract which is marked Deposition Exhibit 52 [the Prescription Drug Insurance Policy], along with the Participating Drug Pharmacy Agreement which Blue Shield proposed to issue, was it your opinion *that that* constituted the business of insurance?
>
> A. [Mr. Connor] Yes.

Plaintiff concedes that one might draw from this exchange that Connor though the Pharmacy Agreement was a part of the business of insurance. Plaintiffs argue, however, that the phrase "that that" leaves the issue in doubt because Connor may have understood the phrase "that that" to refer only to the policy itself and not to the Pharmacy

Agreement. This position is bolstered by Connor's earlier testimony, wherein he stated that he did not recall having occasion to review the Pharmacy Agreement before drafting the Exemption Order and that he had "no recollection of receiving the document."

The testimony of these officials, therefore, at best raises a factual issue concerning the State's position. It, like the 1962 Attorney General's Opinion, is not a definitive statement of the State's position.

The defendants nonetheless place great emphasis on the extent of state regulation and attempt to minimize plaintiffs' arguments concerning the "business of insurance." They rely on *Crawford v. American Title Ins. Co.*, 518 F.2d 217 (5th Cir. 1975), where this court held that pervasive regulation by the State of Alabama over antitrust matters in the insurance industry precluded application of the federal antitrust laws. The problem with the defendants' position is that the McCarran Act applies only when the activity concerned is the business of insurance *and* the activity is regulated by the State. In *Crawford* there was no question that the challenged conduct constituted the business of insurance; rather, the issue was the extent and pervasiveness of state regulation. There seems to be no question that the State of Texas regulates the insurance industry quite vigorously, but there is no similar indication that the activities complained of are considered the business of insurance by the State or by any common sense interpretation of that term.[7]

We recognize that several district courts have rendered decisions contrary to the conclusion we reach today. *Mana-*

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[7] The McCarran Act likewise affords no antitrust exemption to the so-called noninsurance company defendants who are parties to this litigation. Indeed, it would be highly anomalous for this court to conclude that the sale of pharmaceuticals by these defendants constitutes the "business of insurance" for purposes of federal antitrust law.

sen v. *California Dental Services,* 424 F.Supp. 657 (N.D.Cal. 1976); *Proctor v. State Farm Mutual Insurance Co.,* 406 F.Supp. 27 (D.D.C. 1975); *Schwartz v. Commonwealth Land Title Insurance Co.,* 374 F.Supp. 564 (E.D.Pa.1974), subsequent proceedings reported at 384 F.Supp. 302 (E.D.Pa. 1974); *Nankin Hospital v. Michigan Hospital Service,* 361 F.Supp. 1199 (E.D.Mich.1973); *California League of Independent Insurance Producers v. Aetna Casualty & Surety Co*, 175 F.Supp. 857 (N.D.Cal. 1969). Indeed, two such cases have been affirmed on appeal. *Anderson v. Medical Service of the District of Columbia,* 551 F.2d 304 (4th Cir. 1977); *Frankford Hospital v. Blue Cross,* 554 F.2d 1253 (3d Cir. May 2, 1977). Perhaps the most far-reaching of these is the *Manasen* case, in which the district court concluded that the McCarran Act exemption applied to a nonprofit corporation engaged in the administration and operation of prepaid dental care programs. The defendant corporation administered prepaid dental care plans under agreements and contracts with various subscriber groups and subscribing purchasers, including governmental bodies, employer organizations, and joint employer-labor trust funds. The subscribers paid periodic premiums to CDS in exchange for future dental services performed for individuals on whose behalf the premiums were paid.

Professional services were performed by practicing dentists who were classified by CDS as "participating" or "nonparticipating" dentists. In order to attain the "participating" status, a dentist was required to look solely to CDS for payment and to set patients' fees at levels not in excess of the amounts established in a CDS approved fee schedule. Any dentist who did not agree to limit his fees to the range specified by CDS would be classified by the corporation as "nonparticipating." Covered patients who selected participating dentists to perform services would receive full benefits under the program. Patients seeking care from nonparticipating dentists, however, would receive less

than the full benefits from CDS. The plaintiffs alleged that this arrangement had the effect of excluding nonparticipating dentists from the CDS market since a CDS patient who sought services from a nonparticipating dentist suffered a financial detriment. Although the defendant corporation was not an insurance company, the court concluded that it was engaged in the business of insurance for McCarran Act purposes. The court placed considerable weight on the favorable impact of the arrangement on the company's insurance rates:

> It is undisputed that the level of dentists' fees are a major factor in determining policy premiums. CDS' payment arrangements to service providers are critical elements in CDS' contractual agreements with its subscribers. These arrangements are intimately related to the interpretation and implementation of CDS' policies and to its reliability as an insurer. Accordingly, the Court finds that the activities challenged in the instant complaint constitute part of the "business of insurance" within the meaning of the McCarran Act.

424 F.Supp. at 666-67 (footnote omitted).

We find ourselves in serious disagreement with the rationale underlying the *Manasen* decision. An activity is not a part of the business of insurance solely because it has an impact, favorable or otherwise, upon premiums charged by the insurer. Monopolistic or coercive activities in "provider industries" may often have a favorable economic impact upon the rates or the costs of insurance companies. But such practices do not become clothed with McCarran Act protection simply because an insurance company has contracted to pay the provider for products or services.

In *SEC v. Nat'l Securities Inc., supra,* the Supreme Court held that the activity of two insurance companies in merging did not constitute the business of insurance, despite the fact that the transaction undoubtedly affected policyholders

in terms of the security of their insurance contracts and the reliability of their insurers. Moreover, business activities of insurance companies not peculiar to the insurance industry are outside the scope of the McCarran Act. *Center Ins. Agency v. Byers,* (N.D.Ill.1976); *American Family Life Assurance Co. v. Planned Marketing Asscciates,* 389 F. Supp. 1141 (E.D.Va.1974); *American General Ins. Co.* v. *FTC,* 359 F.Supp. 887 (S.D.Tex.1973), *aff'd* 496 F.2d 197 (5th Cir. 1974). As indicated by the activities of the noninsurance company in *Manasen, supra,* the activity complained of by plaintiffs is not peculiar to the insurance industry. To be sure, price fixing and coercion induced by firms with superior bargaining power are often found in all industries. Thus, Blue Shield's attempts to control costs in the pharmaceutical industry might just as easily be undertaken by a noninsurance firm attempting to meet a contractual obligation to deliver drugs to a wholesale or retail purchaser.

Manasen and other cases have emphasized the favorable impact that price fixing and coercion have had on insurance premiums and the "reliability" of the insurers. It is conceivable that the public might benefit from price fixing arrangements as long as the parties to the arrangement agree to keep prices below free market levels. The Congress, however, has foreseen that the power to fix prices might not always be beneficially administered by those parties holding the power once their competition has been put out of business. It is quite clear that competitors can be destroyed by those whose financial resources permit them to reduce prices until their competition is eliminated, only for the purpose of raising prices in the long run. Whether such economic coercion is proper is not for a court to decide. It is a matter of national policy which has been addressed by the Congress, from which any change will originate only after appropriate investigation, hearings and deliberation. We apply the law as presently determined by the

Congress and we hold that the antitrust laws are applicable to the arrangements challenged herein.

We conclude, therefore, that Blue Shield's Pharmacy Agreement is not a part of the business of insurance and is not shielded from antitrust scrutiny even though it may have some effect upon the company's policyholders and rates.

REVERSED.

APPENDIX C

Judgment of United States Court of Appeals for the Fifth Circuit, August 8, 1977

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

(Caption deleted in printing)

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed;

It is further ordered that defendants-appellees pay to plaintiffs-appellants, the costs on appeal to be taxed by the Clerk of this Court.

August 8, 1977

Issued as Mandate:

APPENDIX D

Notice of Order Denying Petition for Rehearing and Rehearing En Banc, October 27, 1977

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

OFFICE OF THE CLERK

Tel 504—589-6514

600 Camp Street
New Orleans, La. 70130

Edward W. Wadsworth
Clerk

October 27, 1977

TO ALL PARTIES LISTED BELOW:

No. 76-2746—ROYAL DRUG COMPANY, INC., ETC., ET AL. v. GROUP LIFE AND HEALTH INSURANCE CO., ETC., ET AL.

Dear Counsel:

This is to advise that an order has this day been entered denying the petition( ) for rehearing,* and no member of the panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the petition( ) for rehearing en banc has also been denied.

See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,
EDWARD W. WADSWORTH, *Clerk*
By /s/ BRENDA M. HAUCK
Deputy Clerk

**on behalf of appellees, Group Life and Health Ins. Co.,

APPENDIX E

Relevant Provisions of McCarran-Ferguson Act

McCarran Act § 1, 15 U.S.C. § 1011:

Declaration of Policy.

Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation of taxation of such business by the several States.

McCarran Act § 2, 15 U.S.C. § 1012:

Regulation by State Law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948.

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided,* That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act cf Setember 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

McCarran Act § 3(b), 15 U.S.C. § 1013(b):

Suspension until June 30, 1948, of application of certain Federal laws; Sherman Anti-Trust Act applicable to agreements to, or acts of, boycott, coercion, or intimidation.

• • •

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.